Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014

Message Text

UNCLASSIFIED

PAGE 01 LONDON 00539 01 OF 04 111826Z
ACTION EUR-12

INFO OCT-01 EA-12 IO-14 ISO-00 AID-05 CIAE-00 EB-08
FRB-01 INR-07 NSAE-00 USIA-15 XMB-04 OPIC-06
SP-02 LAB-04 SIL-01 OMB-01 NSC-05 SS-15 STR-06
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DOE-11 SOE-02 DOEE-00 SSO-00 ABF-01 IGA-02 /149 W
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P R 111807Z JAN 78
FM AMEMBASSY LONDON
TO SECSTATE WASHDC PRIORITY 1937
TREASURY DEPT WASHDC PRIORITY
INFO AMEMBASSY BONN
AMEMBASSY BRUSSELS
AMEMBASSY DUBLIN
AMEMBASSY PARIS
AMEMBASSY ROME
AMEMBASSY TOKYO
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UNCLAS SECTION 01 OF 04 LONDON 00539

USEEC ALSO FOR EMBASSY
USOECD ALSO FOR EMBASSY
USMTN

DEPARTMENT PASS FEDERAL RESERVE BOARD; TREASURY FOR
DONALD E. SYVRUD, OASIA

E.O. 11652: N/A
TAGS: EFIN, UK
SUBJECT: ECONOMIC DEVELOPMENTS FOR PERIOD JAN. 5 - 11.

1. WHOLESALE PRICES. WHOLESALE PRICES ENDED 1977 ON A
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PAGE 02 LONDON 00539 01 OF 04 111826Z

NOTE OF MODERATION AS RAW MATERIALS AND FUELS AGAIN DE-
CLINED IN PRICE WHILE FINISHED GOODS PRICES, EX-FACTORY,
ROSE ONLY MODERATELY. THE INDEX OF WHOLESALE PRICES
(1970 EQUALS 100) FOR RAW MATERIALS AND FUELS STOOD AT
328.9 IN DECEMBER, A DECLINE OF 0.4 PERCENT FROM THE RE-
VISED NOVEMBER FIGURE OF 330.2. THIS INDEX HAS DECLINED
FOR EIGHT CONSECUTIVE MONTHS AND NOW STANDS 1.3 PERCENT

Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014

Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014

BELOW ITS LEVEL OF DECEMBER 1976. THE FOLLOWING TABLE SETS OUT THE LATEST WHOLESALE PRICE DATA FOR BOTH RAW MATERIALS AND FINISHED GOODS: (1970 EQUALS 100)

	RAW MATERIALS AND FUELS	PERCENT CHANGE FROM SAME PERIOD 12 MOS. EARLIER	FINISHED GOODS EX-FACTORY	PERCENT CHANGE FROM SAME PERIOD 12 MOS. EARLIER
1976	299.0	27.0	219.6	16.4
1977 (PROV.)	340.2	13.8	261.7	19.2
1977 - I	341.5	28.1	248.0	19.9
II	347.7	18.8	259.2	20.9
III	340.5	11.0	267.7	20.0
IV(PROV.)	331.0	0.3	272.0	16.3
SEPT.	338.1	7.5	269.2	19.0
OCT.	333.8	1.9	271.0	17.8
NOV.(PROV.)	330.2	- 0.5	271.8	15.9
DEC.(PROV.)	328.9	- 1.3	273.3	15.2

THESE FIGURES SHOWING 12-MONTH RATES OF CHANGE UNDERSTATE THE IMPROVEMENTS OF THE PAST SIX MONTHS WHEN MATERIALS PRICES WERE FALLING AT AN ANNUAL RATE OF 9.4 PERCENT. MATERIALS PRICES SHOULD CONTINUE TO FALL DURING THE EARLY PART OF 1978 AS STERLING'S RECENT APPRECIATION IS REFLECTED IN THE JANUARY FIGURES AND PERHAPS BEYOND.

FINISHED GOODS PRICES ARE ALSO IMPROVING. WHOLESALE PRICE INDEX FOR GOODS EX-FACTORY (1970 EQUALS 100) STOOD

AT 273.3 IN DECEMBER, A RISE OF 0.6 PERCENT FROM THE REVISED NOVEMBER FIGURE OF 271.8. OVER THE PAST SIX MONTHS THIS INDEX HAS RISEN AT AN ANNUAL RATE OF 8.3 PERCENT COMPARED WITH AN ANNUAL RATE OF 21.2 PERCENT IN THE PREVIOUS SIX-MONTH PERIOD. AGAIN THE OUTLOOK IS FOR FURTHER REDUCTIONS IN THE 12-MONTH RATE OF INCREASE AS AN UNDERLYING TREND PRODUCING ANNUALIZED RATES IN SINGLE DIGITS BECOMES ESTABLISHED.

2. THE ELIGIBLE LIABILITIES (ELS) OF THE BANKING SYSTEM INCREASED 1.6 PERCENT IN THE BANKING MONTH ENDED DECEMBER 14. MARKET SOURCES INDICATE THAT THIS IS DOUBLE THE ANTICIPATED INCREASE. ALTHOUGH SEASONAL AND OTHER ADJUSTMENTS OUGHT TO REDUCE THE CORRESPONDING INCREASE IN STERLING M3, THERE IS INCREASED CONCERN THAT THE 9-13 PERCENT TARGET RANGE FOR STERLING M3 GROWTH MAY NOT BE MET. THE SHARP INCREASE IN ELS HAS BEEN ATTRIBUTED BY MARKET ANALYSTS TO THE SUBSTANTIAL GOVERNMENT BORROWING REQUIREMENT WHICHAROSE FROM TAX REBATES AND PENSIONERS'CHRISTMASBONUS. ANOTHER FACTOR IS CLEARLY THE REDUCTION IN THE RESERVE RATIO OVER THE MONTH WHICH FELL FROM 15.1 TO 14.8 PERCENT AFTER AN 0.6 PERCENT RISE THE PREVIOUS MONTH. THE LEVEL

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OF RESERVE ASSETS WAS VIRTUALLY UNCHANGED OVER THE BANK-
ING MONTH. THE FOLLOWING TABLE SUMMARIZES THE MOST RE-
CENT STATISTICS ON ELS:

	NOVEMBER 16	DECEMBER 14
ELIGIBLE LIABILITIES	40,196	40,841
OF WHICH INTEREST-BEARING	26,483	26,805

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PAGE 01 LONDON 00539 02 OF 04 111830Z
ACTION EUR-12

INFO OCT-01 EA-12 IO-14 ISO-00 AID-05 CIAE-00 EB-08
FRB-01 INR-07 NSAE-00 USIA-15 XMB-04 OPIC-06
SP-02 LAB-04 SIL-01 OMB-01 NSC-05 SS-15 STR-06
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AMCONSUL EDINBURGH
USMISSION GENEVA
USDOC WASHDC

UNCLAS SECTION 02 OF 04 LONDON 00539

RESERVE ASSETS	6,064	6,060
OF WHICH BALANCES WITH THE		
BANK OF ENGLAND	289	425
MONEY AT CALL IN THE DISCOUNT		
MARKET	2,357	2,566
U.K. AND NORTHERN IRELAND		
TREASURY BILLS	1,628	1,549

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BRITISH GOVERNMENT STOCKS WITH
UP TO ONE YEAR TO MATURITY 675 432

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3. PERSONAL INCOME. REAL DISPOSABLE PERSONAL INCOME ROSE IN THE THIRD QUARTER. AFTER FOUR QUARTERS OF DECLINE, REAL DISPOSABLE PERSONAL INCOMES ROSE BY 1.1 PERCENT IN THE THIRD QUARTER. THE RISE WAS DUE IN PART TO AN EASING IN RETAIL PRICE INFLATION AND THE IMPACT OF THE TAX CUT ANNOUNCED IN THE APRIL 1977 BUDGET WHICH GAVE INDIVIDUALS A TAX REBATE AND LOWER WITHHOLDING RATES. AS A RESULT, NOMINAL DISPOSABLE INCOMES ROSE BY 4.0 PERCENT. THE FIGURES ALSO REVEAL THAT THE SAVINGS RATIO DECLINED TO 12.8 PERCENT OF DISPOSABLE INCOME FROM 13.1 PERCENT IN THE SECOND QUARTER AS CONSUMERS INCREASED THEIR SPENDING VOLUME BY 1.5 PERCENT. THE FOLLOWING TABLE SUMMARIZES THE MOST RECENT QUARTERLY DATA:

	PERSONAL DISPOSABLE INCOME(1970 PRICES) BNS. OF POUNDS	PERCENT CHANGE FROM 12 MOS. EARLIER	SAVINGS RATIO (PERCENT)
1976 - III	10.489	1.8	15.4
IV	10.267	0.4	13.3
1977 I	10.210	- 2.3	14.2
II	9.970	- 2.7	13.1
III	10.084	- 3.9	12.8

IT SEEMS LIKELY THAT THE SLIDE IN REAL INCOME CAME TO AN END IN THE SECOND QUARTER OF 1977. THE SAME COMBINATION OF TAX CUTS AND SLOWER RATE OF PRICE INCREASE WAS AGAIN PRESENT DURING THE FOURTH QUARTER AND YET FURTHER TAX CUTS ARE EXPECTED TO INFLUENCE DISPOSABLE INCOMES DURING THE SECOND HALF OF 1978.

4. PRICE COMMISSION ISSUES INITIAL REPORTS. USING ITS NEW INVESTIGATIVE POWERS, THE PRICE COMMISSION PUBLISHED THE RESULTS OF THREE INQUIRIES INTO PROPOSED PRICE INCREASES BY BARCLAYS BANK, THE METAL BOX COMPANY, AND INDIVIDUAL AREA ELECTRICITY BOARDS. THE COMMISSION HAS DE-
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CIDED THAT THE PROPOSED PRICE INCREASES WERE JUSTIFIED BUT HAS QUESTIONED CERTAIN ASPECTS OF PRICING BAHAVIOR. THE NEW PRICE COMMISSION PROCEDURES WENT INTO FORCE LAST AUGUST. THEY SHIFT THE COMMISSION'S EMPHASIS TO ONE OF SPOT CHECKS FROM ONE OF VETTING EVERY APPLICATION FOR A PRICE RISE. THESE INITIAL INVESTIGATIONS WERE ANNOUNCED

Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014

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LAST SEPTEMBER. WHILE THE COMMISSION IS CRITICAL OF SOME ASPECTS OF PRICE SETTING BEHAVIOR IN EACH OF THE CASES, THE OUTCOME OF THE INVESTIGATION IS LIKELY TO PRODUCE A SIGH OF RELIEF IN INDUSTRY WHICH HAD BEEN QUITE WORRIED ABOUT THE SCOPE OF THE COMMISSION'S NEW POWERS.

5. RETAIL SALES. RETAIL SALES VOLUME DATA WERE REVISED UPWARD IN NOVEMBER. THE INDEX OF RETAIL SALES VOLUME (1971 EQUALS 100) STOOD AT 106.1 IN NOVEMBER COMPARED WITH A PROVISIONAL ESTIMATE OF 105.0. THIS IS A RISE OF 0.7 PERCENT FROM THE OCTOBER FIGURE OF 105.4. THE INDEX IS CURRENTLY 2.8 PERCENT BELOW ITS LEVEL OF NOVEMBER 1976 AND 1.0 PERCENT BELOW ITS LEVEL OF AUGUST 1977. THE FOLLOWING TABLE SUMMARIZES THE LATEST SALES VOLUME DATA:

	(1971 EQUALS 100)	PERCENT CHANGE FROM 12 MONTHS EARLIER
1977 - I	105.0	- 2.1
II	103.9	- 3.4
III	106.8	- 1.9
SEPT.	106.2	- 2.5
OCT.	105.4	- 2.5
NOV.	106.1	- 2.8

THE NOVEMBER IMPROVEMENT IS LARGELY DUE TO A RECOVERY IN "CLOTHING AND FOOTWEAR"SALES (UP 2.9 PERCENT). DURABLE GOODS VOLUME DECLINED (DOWN 1.6 PERCENT) WHILE FOOD SALES AND "OTHER NON-FOOD"SALES SHOWED MARGINAL RISES. DESPITE THE NOVEMBER INCREASE, IT WOULD REQUIRE A NEARLY 3 PERCENT RISE IN DECEMBER TO BRING THE FOURTH QUARTER VOLUME TO THE LEVEL ACHIEVED DURING THE THIRD QUARTER.
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PAGE 04 LONDON 00539 02 OF 04 111830Z

6. INSTALLMENT CREDIT. NEW INSTALLMENT CREDIT EXTENDED BY RETAILERS AND FINANCE HOUSES INCREASED IN NOVEMBER. FINANCE HOUSES EXTENDED 200 MILLION POUNDS IN NEW CREDIT IN NOVEMBER COMPARED WITH 173 MILLION IN OCTOBER WHILE RE-

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UNCLAS SECTION 03 OF 04 LONDON 00539

TAILERS EXTENDED 200 MILLION POUNDS AFTER 213 MILLION IN OCTOBER. OVER THE LATEST THREE MONTHS FINANCE HOUSES SHOWED A 5 PERCENT RISE IN NEW CREDIT, THE INCREASE FOR RETAILERS WAS 8 PERCENT. AT THE END OF NOVEMBER THE TOTAL DEBT OUTSTANDING TO RETAILERS AND FINANCE HOUSES WAS 3.213 BILLION POUNDS COMPARED WITH 3.113 BILLION POUNDS IN OCTOBER AND 2.605 BILLION A YEAR EARLIER.

7. STATISTICS FROM THE LONDON CLEARING BANKS SHOW AN INCREASE OF 183 MILLION POUNDS, OR 0.9 PERCENT, IN STERLING
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ADVANCES IN THE BANKING MONTH ENDED DECEMBER 14. STERLING ADVANCES TO THE U.K. PRIVATE SECTOR INCREASED 100 MILLION POUNDS, OR 0.6 PERCENT. THERE IS A SUBSTANTIAL AMOUNT OF INTERBANK ACTIVITY RECORDED IN THE STATISTICS THIS MONTH. OF THE 351 MILLION POUND INCREASE IN STERLING DEPOSITS, 151 MILLION POUNDS ARE FROM THE U.K. BANKING SYSTEM. CASH AND BALANCES WITH THE BANK OF ENGLAND GREW 283 MILLION POUNDS, WHILE"OTHER STERLING ASSETS", AN ENTITY WHICH INCLUDES ITEMS IN SUSPENCE AND IN TRANSIT, INCREASED 225 MILLION POUNDS COMPARED WITH AN INCREASE OF 586 MILLION

Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014

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POUNDS IN TOTAL STERLING ASSETS.

8. FOREIGN EXCHANGE MARKETS HAVE BEEN MORE SETTLED BUT ARE STILL NERVOUS FOLLOWING THE JANUARY 4 ANNOUNCEMENT OF GREATER U.S. INTERVENTION. DEALERS REPORT THAT THIS WEEK THE POUND HAS BEEN LARGELY ON THE SIDELINES, THE MAIN ACTIVITY BEING IN DOLLARS, DM AND SWISS FRANCS. ON TUESDAY JANUARY 10, IT LOOKED AS IF AN IMPROVED MEASURE OF STABILITY HAD FINALLY RETURNED; UNFORTUNATELY, TRADING EARLY MORNING ON WEDNESDAY REVERSED THE TREND, WITH QUICK FALLS AGAINST THE DM AND SWISS FRANC, DESPITE OBVIOUS INTERVENTION. BY NOON, THE REPORTED SAUDI PLANS TO CONTINUE THE OIL PRICE FREEZE UNTIL THE END OF 1978 HAD ALLEVIATED SOME OF THE PRESSURE BUT THE DOLLAR REMAINS A TARGET.

9. THE BRITISH ELECTRICITY COUNCIL ANNOUNCED THAT IT WILL SHORTLY REPAY $500 MILLION OF FOREIGN DEBT ARRANGED NOVEMBER 1976 UNDER HMTREASURY'S FOREIGN EXCHANGE COVER SCHEME. THE CREDIT, WHICH WOULD HAVE BEEN DUE MAY OF 1982, CARRIED AN INTEREST RATE OF 1.25 PERCENT OVER THE LONDON INTERBANK DOLLAR OFFER RATE (LIBO). THE SPREAD OVER LIBO IS HIGHER THAN THOSE CURRENTLY AVAILABLE IN THE EUROCURRENCY MARKET. THE PRESS SUGGESTS THAT U.K. OFFI-
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CIALS DO NOT REGARD THIS REPAYMENT AS PART OF A LARGE REDUCTION IN THE U.K. EXTERNAL DEBT, NOTING THAT 360 MILLION DOLLARS HAVE BEEN BORROWED SINCE OCTOBER.

10. FINANCIAL MARKETS. THE YIELD CURVE MORE PERCEPTIBLY STEEPENED THIS WEEK AS SHORT-TERM RATES FELL AND LONGER-TERM RATES ROSE. THE MINIMUM LENDING RATE FELL BY 1/2 PERCENT TO 6-1/2 PERCENT AFTER FRIDAY'S TREASURY BILL AUCTION. THE LARGER CLEARING BANKS REDUCED THEIR BASE LENDING RATE IN TURN 1 PERCENT TO 6-1/2 PERCENT AND THEIR RATES ON SEVEN-DAY DEPOSITS FROM 4-1/2 TO 3 PERCENT, AND OTHER BANKS FOLLOWED THE MOVE. MARKET SOURCES SAY THAT THIS DECLINE HAD BEEN EXPECTED FOR SEVERAL DAYS.

GILT PRICES ON THE OTHER HAND FELL THROUGH MOST OF THIS WEEK, WITH REDEMPTION YIELDS FALLING ON THE ORDER OF 0.30 PERCENT. MARKET SOURCES THINK THE WEAKNESS REFLECTS A TEMPORARY LACK OF LIQUIDITY WHICH HAS BEEN INTENSIFIED BY MONDAY'S 320 MILLION POUND CALL ON THE PARTIALLY PAID TREASURY 10-1/2 PERCENT 1999. A NEW 800 MILLION POUND ISSUE WAS UNEXPECTEDLY ANNOUNCED ON MONDAY. IT IS THE 10-1/4 PERCENT EXCHEQUER 1995, PRICED AT 95 POUNDS PER 100 POUNDS APPLIED FOR, AND A GROSS YIELD TO REDEMPTION OF 10.895 PERCENT. OF THE 95 POUNDS, 30 POUNDS ARE DUE ON APPLICATION AND 65 POUNDS ON FEBRUARY 27, 1978. MARKET SOURCES FEEL THAT THE NEW ISSUE YIELD IS SUFFICIENTLY LOW

Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014

Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014

AND THE MARKET SUFFICIENTLY WEAK THAT THERE WILL BE NO
OVERSUBSCRIPTION.

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PAGE 01 LONDON 00539 04 OF 04 111837Z
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UNCLAS SECTION 04 OF 04 LONDON 00539

11. EXCHANGE RATE AND GOLD

DATE	EXCHANGE RATE ($)	EFFECTIVE EXCHANGE RATE (DEC. 1971 EQUALS 100)	GOLD ($)
1/4	1.9620	66.2	171-7/8
1/5	1.8880	64.7	166-1/8
1/6	1.9300	65.3	169-7/8
1/9	1.9175	65.8	171-1/8

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Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014

Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014

UNCLASSIFIED

1/10	1.9185	65.7	173-1/8
CHANGE 1/3-1/10	DN. 0.0450	DN. 0.4	UP 4

12. FORWARD PREMIUM ON STERLING

DATE	1 MONTH	3 MONTHS	6 MONTHS
1/4	0.05	0.27	0.69
1/5	0.02	0.13	0.35
1/5	0.17	0.33	0.72
1/9	0.17	0.45	0.93
1/10	0.15	0.45	0.95
CHANGE 1/3-1/10	UP 0.07	UP 0.10	UP 0.32

(ALL FIGURES IN CENTS)

13. EURODOLLAR INTEREST RATES

DATE	1 MONTH	3 MONTHS	6 MONTHS
1/4	6-5/8	7-1/8	7-1/2
1/5	7	7-1/8	7-1/2
1/6	7-1/2	7-1/8	7-1/2
1/9	7-1/8	7-3/8	7-3/4
1/10	7-1/8	7-1/2	7-3/4
CHANGE 1/3-1/10	UP 1/4	UP 1/8	UP 1/4

14. THREE-MONTH LONDON INTERBANK - EURODOLLAR INTEREST RATE DIFFERENTIAL

DATE	
1/4	- 7/8
1/5	- 13/16
1/6	- 1
1/9	- 1-1/4
1/10	- 1-11/32
CHANGE 1/3-1/10	DOWN 13/16

15. STERLING CERTIFICATES OF DEPOSIT

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DATE	1 MONTH	3 MONTHS	6 MONTHS
1/4	6-7/16	6	6-3/32
1/5	6-1/8	6-1/8	6-5/16
1/6	6-13/32	6-3/64	6-7/32
1/9	6-13/32	6-1/64	6-1/4
1/10	6-7/16	6-5/64	6-7/32
CHANGE 1/3-1/10	DOWN 1/8	DOWN 7/32	DOWN 3/32

16. INTERPOLATED REDEMPTION YIELDS OF HIGH COUPON GOVERNMENT SECURITIES

Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014

Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014

DATE	5 YEARS	15 YEARS	25 YEARS
1/4	9.74	11.18	11.30
1/5	9.81	11.23	11.34
1/6	9.93	11.29	11.37
1/9	9.91	11.30	11.38
1/10	10.04	11.42	11.50
CHANGE 1/3-1/10	UP 0.37	UP 0.29	UP 0.31

17. THE MINIMUM LENDING RATE FELL 1/2 PERCENT TO 6-1/2 PERCENT FOLLOWING FRIDAY'S TREASURY BILL AUCTION. THE AVERAGE TREASURY BILL RATE FELL 0.4105 PERCENT TO 5.8826 PERCENT AT THEAUCTION AS 1,230.27 MILLION POUNDS IN BIDS WERE RECEIVED FOR THE 400 MILLION POUNDS IN BILLS OFFERED. THIS WEEK 300 MILLION POUNDS IN BILLS WILL BE OFFERED AS A SIMILAR AMOUNT MATURES.

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To: STATE TRSY
Type: TE
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20 Mar 2014
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